



# County of Los Angeles CHIEF EXECUTIVE OFFICE

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WILLIAM T FUJIOKA  
Chief Executive Officer

August 19, 2011

To: Mayor Michael D. Antonovich  
Supervisor Gloria Molina  
Supervisor Mark Ridley-Thomas  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe

From: William T Fujioka  
Chief Executive Officer

Board of Supervisors  
GLORIA MOLINA  
First District

MARK RIDLEY-THOMAS  
Second District

ZEV YAROSLAVSKY  
Third District

DON KNABE  
Fourth District

MICHAEL D. ANTONOVICH  
Fifth District

## **CITY OF VERNON PROPOSED DISINCORPORATION (SUPPLEMENTAL AGENDA OF AUGUST 23, 2011)**

On August 16, 2011, the Board approved a motion directing the Chief Executive Officer to determine the fiscal impact of the City of Vernon's debt on the County's budget should Assembly Bill (AB) 46 and AB 781 pass, resulting in the disincorporation of the City of Vernon and the establishment of a Community Services District within the County. This report includes input from the Auditor-Controller, Treasurer and Tax Collector, and County Counsel.

Based on the review of the City of Vernon's Annual Financial Report for Fiscal Year Ended June 30, 2010 and other public records, the significant findings related to the City of Vernon's General Fund are as follows:

### **Effect of AB 781 on Provision of Services in the Disincorporated City**

AB 781 would establish a Community Services District (CSD) consisting of the territory of the disincorporated city with the County Board of Supervisors acting as the Board of Directors of the CSD. Attachment I identifies the municipal service providers currently for the City of Vernon and as proposed in AB 781. AB 781 would also appoint the Board of Supervisors as the legislative body of the disincorporated city's Redevelopment Agency.

*"To Enrich Lives Through Effective And Caring Service"*

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### **General Fund Structural Deficit**

Based on available information, Vernon's General Fund Fiscal Year (FY) 2009-10 expenditures of \$51.7 million exceeded revenues of \$18.3 million, producing an operating deficit of \$33.4 million.

In FY 2009-10, Vernon covered this deficit by making \$42.8 million of transfers from other funds to its General Fund, thereby producing an overall fiscal year surplus of \$9.4 million. The \$42.8 million of fund transfers came from the following sources:

- \$21.7 million from the Parcel Tax Fund to reimburse "prior years' public works cost expended in the General Fund." The report does not disclose the number of reimbursement years; however, this amount of money represents approximately three years worth of such parcel taxes.
- \$8.6 million from the Light & Power Fund which transferred \$3.1 million of "in-lieu franchise taxes" and \$5.5 million to "meet the operations of (the General) fund."
- \$7.0 million from the Industrial Development Fund to make a "fund balance transfer." The Industrial Development Fund was discontinued and consolidated with Vernon's General Fund during FY 2009-10 and the transfer represented surplus money to carry out future industrial development projects.
- \$5.4 million from the Internal Service Funds to transfer fund balances. The Internal Service Funds were also discontinued during FY 2009-10 and consolidated with Vernon's General Fund. These funds were initially established to fund various employee benefits, such as workers compensation and employee health insurance. Future costs were to be directly charged to Vernon's General Fund.
- \$0.1 million from the Redevelopment Agency Fund for "purchase of a Graffiti Truck."

As described above from Vernon's financial statements, a significant portion of the funds transferred can be characterized as one-time in nature. As of June 30, 2010, Vernon's General Fund reported a *negative* unreserved fund balance of nearly \$11.0 million. This weak financial condition, coupled with the recent heavy reliance on intrafund transfers, would not be sustainable without identifying new General Fund revenue sources or expenditure curtailments.

By accessing online audited financial statements for all available periods, the Auditor-Controller compiled a five year history of the City of Vernon's Statement of Revenues, Expenditures and Changes in Fund Balances for the General Fund, (see Attachment II). For each of the five years, expenditures exceeded revenues by amounts ranging from \$20.6 million to \$33.4 million. These deficits were managed by using fund balance reserves, selling real estate assets, and transfers from other funds.

In addition to the General Fund financial condition summarized above, Vernon's assets and liabilities are mostly concentrated in its utility operations, which are separately accounted for in Vernon's Enterprise Funds. As of June 30, 2010, the assets of the Enterprise Funds exceeded \$700 million and there were associated liabilities of nearly \$600 million. The size and complexity of these utility operations make it very difficult to compare Vernon with other municipalities. As discussed below, Vernon has significant amounts of long-term debt and has entered into contractual commitments known as "interest rate swaps". In addition, natural gas has been advance-purchased and an estimated \$311 million of Enterprise Fund Assets consist of prepaid natural gas. There are long-term risks associated with the utility operations which will require access to Vernon's records and evaluation by someone knowledgeable of this specialized area.

### **Long-Term Debt**

The Treasurer and Tax Collector (TTC) identified four outstanding long-term debt obligations and at least two "interest rate swaps".

Basic details of each bond issue are described on the attached worksheet, (see Attachment III).

#### *Long-Term Bonds*

There are two series of Industrial Redevelopment Tax Allocation Bonds and two series Electric System Revenue Bonds.

- \$463,165,000 in bonds was issued in two Electric System Revenue Bond transactions, with \$444,940,000 outstanding as of July 1, 2011. Debt service on these bonds is payable solely from electric system revenues. This is not a City of Vernon General Fund debt and would not become a County obligation. AB 781, which provides that the CSD would serve as the successor to the city with respect to electric utility services, does not transform these revenue bonds into a County obligation.

- \$68,910,000 in bonds was issued in two City of Vernon Redevelopment Agency transactions, with \$66,464,000 outstanding as of July 1, 2011. Debt service on these bonds is payable solely from the Redevelopment Agency's share of tax increment. This is not a City of Vernon General Fund debt and would not become a County obligation. As discussed below, if the City of Vernon Redevelopment Agency is dissolved, the outstanding bond debt would need to be assumed by a successor agency, which would also receive sufficient tax increment revenue necessary to meet those obligations.

### *Interest Rate Swaps*

With respect to the City of Vernon's long-term debt obligations, the TTC is most concerned about the use of significant financial derivatives known as "interest rate swap" transactions that appear to remain outstanding. The two swaps identified are from 2004 and were designed to "synthetically" convert variable interest rate obligations into fixed interest rate obligations. In 2009, the City refunded its outstanding variable rate bonds, but chose to leave some of their existing swaps outstanding, likely because it was, and remains too costly (perhaps \$30+ million) to terminate the remaining contracts with the swap providers.

It is estimated that the City recently incurred more than \$5.0 million in annual financial losses with respect to these swaps (\$174.0 million notional value) and maintains a significant ongoing loss exposure due to these transactions. TTC recommends securing copies of the swap contracts and hiring an outside professional to analyze their structure and termination costs to better assess the viability and determine the options that are available with respect to these transactions. It appears that the swap contracts are a direct obligation of the electric utility system, but it has not been confirmed whether there is any potential recourse to the City of Vernon General Fund.

### **Redevelopment Agency**

Due to the passage of ABX1 26 and ABX1 27, as a part of the FY 2011-12 State's budget deal, the future of redevelopment agencies in California are uncertain. ABX1 26 dissolves all redevelopment agencies and redirects the tax increment funding of those agencies. ABX1 27 allows those redevelopment agencies that agree to pay an annual remittance to the State to continue in existence. Portions of ABX1 26 and ABX1 27 have been stayed by the State Supreme Court due to legal challenges. A decision as to the constitutionality of ABX1 26 and ABX1 27 is anticipated in January 2012. The Vernon Redevelopment Agency received approximately \$10.3 million in net tax increment and would need to remit \$4.9 million in January 2012 to remain in existence and lesser annual remittances thereafter. Were the Redevelopment Agency to be

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dissolved pursuant to ABX1 26, the outstanding bond debt would need to be assumed by a successor agency, which would also receive sufficient tax increment revenue necessary to meet those obligations.

### **Public Records Request**

The Auditor-Controller has indicated that it is critical for the County to obtain updated financial information for Vernon so that the County can identify the actual revenues, expenditures, and fund transfers which were realized during FY 2010-11 and determine the current available fund balance position of Vernon's General Fund and other funds. Additionally, TTC does not have enough information to conduct a complete and thorough analysis of the City's debt profile without access to all of the original bond documents and related documentation.

Therefore, with the assistance of County Counsel, a Public Records Request will be prepared to submit to the City of Vernon to obtain vital documents in order for the County to determine the City of Vernon's financial viability through a comprehensive audit. It should be noted that others, including the Speaker of the Assembly have submitted similar requests with no ability to secure such records.

If you have any questions regarding this report, please contact Ryan Alsop at (213) 974-1100, or via e-mail at [ralso@ceo.lacounty.gov](mailto:ralso@ceo.lacounty.gov).

WTF:RA:os

### **Attachments**

c: Executive Office, Board of Supervisors  
County Counsel  
Auditor-Controller  
Treasurer and Tax Collector

**Municipal Service Providers -- Existing and Proposed**  
**Vernon Disincorporation**

<b>Service</b>	<b>Present Provider</b>	<b>After Disincorporation</b>
<b>Public Protection</b>		
Law Enforcement	City of Vernon Police	LA County
Traffic Control/Accident Investigation	City of Vernon	CHP
Fire Protection & Paramedic Consolidated	City of Vernon	CSD
Animal Control	Southeast Area Animal Control Authority	SAACA or LA County
Vector Control and Mosquito Abatement	City of Vernon/Health	LA County
<b>Land Use and Planning</b>		
Zoning Code Enforcement (incl. Garment Manufacturing)	City of Vernon	LA County
Land Use Application Processing	City of Vernon	LA County
Building Inspection & Plan Check	City of Vernon /Health	LA County
Advance Planning	City of Vernon	LA County
Economic Development/Redevelopment	City of Vernon	LA County
<b>Community Services</b>		
Environmental Health (incl. Cross Connection, CA Accidental Release Program, Food Safety, Garment Manufacturing (Occ.Health) and Sanitation Standards)	City of Vernon/Health	LA County
<b>Public Works</b>		
Above Ground Storage Tanks	City of Vernon/Health	LA County
Road Maintenance (incl. Weed Abatement)	City of Vernon	LA County
Building and Safety (incl. Grading Permits)	City of Vernon	LA County
Graffiti Abatement	City of Vernon	
Hazardous Materials	City of Vernon/Health	LA County
Hazardous Waste	City of Vernon/Health	LA County
Signal Maintenance	City of Vernon	LA County
Street Lighting	City of Vernon	LA County
Traffic Control	City of Vernon	LA County
Stormwater Quality/NPDES	City of Vernon/Health	LA County
Flood Control & Conveyance Drainage	LA County, Flood Control District	No Change
Solid Waste Management (incl. Recycling)	City of Vernon	LA County
Solid Waste Collection/Disposal	City of Vernon/Health	
Underground Tanks	City of Vernon/Health	LA County
<b>Wastewater Collection</b>	Los Angeles County Sanitation Districts #1, 2, & 23	No Change
<b>Wastewater Treatment/Disposal</b>	Los Angeles County Sanitation Districts #1, 2, & 23	No Change
<b>Domestic Water</b>	City of Vernon	CSD
<b>Other Services</b>		
Electricity	City of Vernon	CSD
Gas	City of Vernon	CSD
Cable Television	Time Warner	No Change
Business License	City of Vernon	LA County

**CITY OF VERNON, CALIFORNIA**  
**Statement of Revenues, Expenditures and Changes in Fund Balances**

General Fund

For the Fiscal Years Ended June 30, 2006 to June 30, 2010							% Increase (Decrease) from FY 2006 to FY 2010
	FYE June 30, 2006	FYE June 30, 2007	FYE June 30, 2008	FYE June 30, 2009	FYE June 30, 2010		
REVENUES:							
Taxes	\$ 8,943,668	\$ 9,551,720	\$ 10,675,889	\$ 9,652,816	\$ 8,175,484		-9%
Special assessments	736,221	840,404	772,086	1,038,602	1,090,346		48%
Licenses and permits	1,161,188	1,364,292	1,236,622	1,222,770	1,351,739		16%
Fines, forfeitures and penalties	188,988	178,517	249,235	302,569	306,919		62%
Investment income	1,700,801	232,452	159,421	25,677	15,114		-99%
Intergovernmental revenues	290,414	272,107	539,854	1,773,938	2,725,165		838%
Charges for services to enterprise funds	8,674,077	8,710,449	8,861,811	2,541,019	3,590,166		-59%
Other revenues	697,254	1,324,890	1,428,699	996,478	1,098,835		58%
Total revenues	\$ 22,392,611	\$ 22,474,831	\$ 23,923,617	\$ 17,553,869	\$ 18,353,768		-18%
EXPENDITURES:							
General government	15,754,912	14,454,372	13,919,675	16,716,155	18,874,342		20%
Public safety	18,657,690	19,194,101	21,630,258	23,572,030	23,216,320		24%
Public works	5,010,187	5,052,726	4,971,701	5,276,794	5,424,865		8%
Health services	1,246,963	1,229,530	1,421,492	1,468,191	1,210,750		-3%
Capital outlay	11,504,180	3,114,509	3,155,167	3,938,884	2,948,547		-74%
Debt Service-Bond Principal	-	-	-	-	57,353		-1%
Total expenditures	52,173,932	43,045,238	45,098,293	50,972,054	51,732,177		
Deficiency of revenues under expenditures	(29,781,321)	(20,570,407)	(21,174,676)	(33,418,185)	(33,378,409)		
Other financing sources (uses):							
Sale of property	43,985	18,552,395	7,530,785	17,729	1,197		
Transfers in	2,975,870	3,371,073	3,401,651	33,555,856	42,834,006		1339%
Transfers out	(24,511,474)	(2,870,349)	(16,509,727)	(1,125,876)	-		
Total other financing sources (uses)	(21,491,619)	19,053,119	(5,577,291)	32,447,709	42,835,203		
NET CHANGE IN FUND BALANCE							
FUND BALANCE ADJUSTMENT	(51,272,940)	(1,517,288)	(26,751,967)	(970,476)	9,456,794		
FUND BALANCE, BEGINNING OF YEAR	72,233,702	20,960,762	28,043,474	1,291,507	4,319,403		
FUND BALANCE, END OF YEAR	\$ 20,960,762	\$ 28,043,474	\$ 1,291,507	\$ 321,031	\$ 14,097,228		-33%

LONG-TERM DEBT OBLIGATIONS

Issuer	Description	Source of Payment	Issue Date	Maturity	Initial Par	As of June 30, 2011	
						Outstanding Par	
City of Vernon	Electric System Revenue Bonds 2008 Taxable Series A	Electric System Revenues	September 24, 2008	July 1, 2038	\$43,765,000	\$43,215,000	
	Electric System Revenue Bonds 2009 Series A	Electric System Revenues	May 13, 2009	August 1, 2021	419,400,000	400,940,000	
				Sub-Total	\$463,165,000	\$444,155,000	
Redevelopment Agency of the City of Vernon	Industrial Redevelopment Project Tax Allocation Bonds, Series 2005	RDA Property Tax Revenues	October 12, 2005	September 1, 2035	\$49,420,000	\$46,975,000	
	Industrial Redevelopment Project Tax Allocation Bonds, Series 2011 (Federally Taxable)	RDA Property Tax Revenues	March 4, 2011	September 1, 2030	19,490,000	19,490,000	
				Sub-Total	\$68,910,000	\$66,465,000	
				Total	\$532,075,000	\$510,620,000	

INTEREST RATE SWAPS

Obligor	Counterparty	Source of Payment	Effective Date	Maturity Date	Notional Amount	As of June 30, 2010	
						Fair Value	
City of Vernon	Morgan Stanley	Electric System Revenues	December 2004	April 2037	\$90,150,000	(\$18,059,693)	
City of Vernon	Morgan Stanley	Electric System Revenues	December 2004	April 2029	83,575,000	(13,175,398)	
				Total	\$173,725,000	(\$31,235,091)	